



STATE BOARD OF EQUALIZATION

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September 28, 1989

Dear Mr.

This is in response to your September 14, 1989 letter to Mr. Richard Ochsner wherein you stated that you represent various developers and operators of alternative energy power plants, all of which are dependent upon various fuels to generate electricity and steam; that the plants are fuel intensive and hence, large quantities of fuel are stored at plant sites so that the plants can generate power on a continuous basis; and that fuels consumed in generating power are "raw materials" for "finished goods"/energy for purposes of Revenue and Taxation Code section 129 and Property Tax Rule 133. In view thereof, you request a ruling that "fuel to be consumed in generating electricity is a raw material which becomes an integral part of the finished product and is therefore considered business inventory and not supplies" for property tax assessment purposes.

Initially, the business inventory exemption from property taxation, like most exemptions from property taxation, is administered solely by county assessors. Thus, while our interpretations regarding the exemption are designed to promote uniformity throughout the state, it is the interpretations thereof by county assessors that are determinative.

As you have noted, section 129 states that 'business inventories' shall include goods intended for sale in the ordinary course of business and shall include raw materials and work in process with respect to such goods. And rule 133(a)(1) defines "business inventories" eligible for the exemption to include all tangible personal property which will become a part of or are themselves items of personalty held for sale in the ordinary course of business. Thus, "business inventories" includes tangible personal property which will become a part of personalty held for sale in the ordinary course of business as well as personalty itself held for sale in the ordinary course

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of business. On the other hand, "business inventories" does not include tangible personal property which is not physically incorporated into property held for sale in the ordinary course of business.

In cases involving fuels or other catalysts used to produce property held for sale, such fuels and catalysts are not, in our view, "business inventories" for purposes of section 129 and/or rule 133. As indicated in our April 25, 1980 Letter to Assessors No. 80/69, Business Inventory Exemption, at pgs. 3, 10, and 17:

B. MANUFACTURING

1. Do manufacturing supplies qualify for the business inventory exemption?

Answer: Manufacturing supplies, such as nuts, bolts, and screws, that will be incorporated in a product that is to be sold are eligible. Supplies, such as drill bits, that are not physically incorporated into the product are not eligible. Also not eligible are catalysts used to accelerate chemical or physical reaction but which are not intentionally incorporated into the product.

E. AGRICULTURAL ENTERPRISES

2. Are insecticides, fuel and fertilizer held by a farmer subject to the business inventory exemption?

Answer: No, because these items are held for use rather than for sale.

F. PROPERTY HELD FOR LEASE

15. Are the supplies of motor fuels held by an equipment operator eligible for "the business inventory exemption where the fuels are consumed by the operator's equipment during the performance of a job?"

Answer: No. The fuels are neither supplied to the customer nor are they delivered to the customer in the performance of a non-professional service.

In the case of this fuel, it is being used/consumed to generate

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power and there is nothing to indicate that it becomes incorporated into the power to be sold. And even if it could be shown that it did become incorporated into such power, it cannot be said that any such incorporation is intentional. Thus, as such fuel is being held for use and being used rather than being held for sale, we do not agree with the characterization of the fuel as raw material that becomes an integral part of the power and is, therefore, business inventory.

As indicated above, the views expressed in this letter are advisory only and are not binding upon the assessor of any county. Thus, you will, no doubt, wish to consult with individual county assessors in order to ascertain whether such fuel will be assessed in a manner consistent with the conclusions stated above.

In conclusion, our intention is to provide prompt, courteous and helpful responses to inquiries such as yours. Suggestions that help us accomplish this are appreciated.

Very truly yours,



James K. McManigal, Jr.
Tax Counsel

JKM:mw
2785H

cc: Mr. Richard Ochsner
Mr. John Hagerty
Mr. Verne Walton
Mr. Gene Mayer
Mr. Bruce Dear